Jeff Auxier Interview with GuruFocus

Aug 28, 2012 by **Holly LaFon**

Jeff Auxier is the president and chief executive officer of Auxier Asset Management. He is a value-oriented money manager whose Auxier Focus Fund has outperformed the market 125.53% to 23.15% on a cumulative basis since inception in 1999. (As of 6/30/2012 since 7/9/99)

Jeff recently spoke with GuruFocus to answer readers' questions and some of our own. The interview is below:

GuruFocus: I actually just met Don Yacktman this week, we talked about you too.

Jeff Auxier: Don is not only one of the true greats in the investment field but his integrity is unmatched. He was very helpful to us when we started the firm.

He actually spoke highly of you, and that's actually my question: How did you get started with value investing?

When I was 11 years old I started mowing lawn for Robert B Pamplin, the CEO of Georgia Pacific at the time. Under his leadership Georgia Pacific stock rose thirty-fold. It was one of the top performing NYSE stocks in the 1960s. Louisiana Pacific, Georgia Gulf and Plum Creek all came out of the original Georgia Pacific. He was an outstanding value investor, buying only what was extremely unpopular. Then in retirement he and his son Dr. Robert Pamplin, Jr. went on to build one of the top denim producers in the world. I asked him, "why textiles?" and he responded, "they were the cheapest sector in the market." Many purchased at 3-4 times earnings... I was fortunate to be exposed at a young age, through various bookkeeping positions, to world class business operations, together with the highest ethics. I still work for the family today. Talk about lucky. Like Warren Buffett says—chose your heroes carefully. It pays to get a start young with the right values and business principles.

After college, in 1982, I actually cold called Warren Buffett at his office on a fall Saturday. To my surprise he picked up and proceeded to be very nice about advice on a career in the investing field. On going to New York and Wall Street—Buffett's advice —you are better off buying a farm and getting as far from Wall Street as possible. On pursuing an MBA—better to master accounting, which is the language of business. He stressed the need to build a database through daily research on individual securities. My main concern was to find an enduring approach where I would be able to survive through the most challenging economic conditions. I was hooked on the value approach.

So basically you were in the operating business for a long time when you were young, and then how did you transfer to the investing business?

My passion was to be a great business analyst. I wanted my day free to study exceptional businesses and operators. I loved researching and started building an investment practice from scratch by seeking out tough operators who had mastered the game. It was fun to strive to earn the trust of these high achievers.

So you never went to a different style then later came back to value investing? You were just influenced by those people and directly got into value investing?

I have used the same approach since 1982. It works. Buying quality businesses at bargain prices is a good way to go. I would go back centuries and study the great investors. I would read their biographies. It was amazing how the approach to investing was so similar whether, J. Paul Getty in the 1930s or Carlos Slim today.

So you think that Buffett influenced you most, among all investors?

I would say Bob Pamplin first, and then Mr. Buffett. I worked for Mr. Pamplin for over 38 years and was never disappointed—especially with his high grade ethics. I took to heart every bit of advice. Both espoused a systematic low risk approach and a strong margin of safety. Mentally, they were always buying the business, not just a stock.

You say you have a systematic approach. What is it like? Can you describe the process?

The process in terms of overall investing?

Yeah, how do you generate ideas, and what else do you do?

Well, in terms of generating ideas, first of all you need is to be a voracious reader. I strive to research 8 to 10 hours a day. Trade journals, 10Ks, 10Qs, company transcripts, in addition to the mainstream business publications. The 10Ks are probably the best for getting a feel for the operating reality of the business. But the other thing is that I start with is to look throughout history to compare the type macro environment are we in. Are we low debt, high debt, or what kind of recession is it? A balance sheet recession? Or an inventory recession? You start with where we are. Like right now, since the downturn in 2008, we've been in a balance sheet decline, so what I do is go back a couple hundred years and study all the balance sheet declines. One out of eight recessions is balance-sheet driven. So I look and see what has done well. 1929-33, that was a balance sheet depression. Broad diversification is less effective in mitigating risk if it's a balance sheet driven decline. They are very rare, and the recoveries tend to be anemic and vulnerable to outside shocks. So typically, banks don't do well in that kind of environment. Look at an extreme example—Japan. The Nikkei dropped from over 38,000 in 1989 down to under 8,000 by 2009. And your real estate declined for 17 years in a row. I know a lot of value investors are just bottom-up. I think you have to combine both. As a steward of others' money your number one objective is compounding returns on a favorable risk-adjusted basis. So you have to first protect on the downside. If you are down 20%, you have to go back up 25% to break even. If you're down 50%, you're going to have to go up 100%. If you're down 90%, you're going to have to go up 1000%. If you are up 50% in year one and two and down 50% in year 3 you have lost out to a steady 8%. Therefore, the priority is to quantify the risk. Risk, as defined by Warren Buffett, comes from not knowing what you are doing. But what I try to do is own a lot of companies over a number of years and build a database to know more about the specific business than the investing public. We first bought Pepsi in 1983. They had a Mexican accounting scandal. Then 18 months ago, after years of monitoring, the company stumbled and we were ready. You are comparing the operating fundamentals with the price all the time. We bought Waste Management in 1983 at nine times earnings, and then in 1989 we sold it at 40 times earnings. It went up nine-fold. But we still haven't bought Waste Management back. It's still lower today than it was when we sold it in 1989. Investing is the craft of the specific and as a business analyst, you're trying to understand what the business is worth if the market did not exist. Then when the price is compelling you are prepared to move.

What materials do you read? What websites, newspapers, magazines, do you read?

Hundreds of annual reports, 10Ks, 10Qs, Daily, at least probably six papers and then four or five trade journals, company transcripts. You are seeking facts, fundamentals and the truth.

How about GuruFocus?

Yes, I read GuruFocus every day. You do a terrific job for the serious long-term investor. I read many agricultural trade journals, food trade journals. The fastest talker is 70 words per minute; the slowest reader is about 400 words per minute. My goal is to read 2000 words per minute. Verbally, you just can't get it done, at least in my opinion. You have to be a tenacious, vigorous reader. You just have to do your homework every day. There are no shortcuts. Television information is too slow.

So basically your process is probably more like from the big picture rather than drilled down. You said it's a balance sheet recession. Because it's a balance sheet recession, what kind of companies do you want to invest in?

Well, we look at overall debt levels. I have a graph in front of me every day, that shows the total U.S. debt as a percentage of GDP in 1933 was 299.8%, and currently it's over 350%. Two Buffett rules: First of all, don't lose your capital, and the second rule is, never forget the first rule. So if you're in a high-debt period, that's going to mean very anemic growth. Typically with this type of debt in developed countries, you're looking at 1% GDP, so you can't depend on strong tailwinds from the economy or the stock market to bailout poor investment selections. It is critical to work harder to make exceptional buys. When I started in the business, the Dow was under 800, that was in 1982. Well 1982 to 2000, that was a tremendous bull market. But the other thing is, bull markets and bear markets tend to go in 18-year cycles, so in investing you're looking at supply and demand, and you're also looking at cycles. Everything changes. Recently the commodity boom was up to 115 months. That exceeded both the tech boom, which lasted 114 or 113, and I think the housing boom, which was I think 114 months. Everything cycles, so you need to understand where we are in the overall scheme of those cycles. If you're in an 18-year bear market like in 1964 to 1981, the Dow went up 1 point. To survive, you needed to price purchases carefully and sell into bubble valuations (i.e. the Nifty Fifty in 1973).

Do you think that is where we are now?

I would just say with the overall debt levels, you have to work much harder to determine if your investments can thrive in a period of severe deleveraging. All these indexes and ETFs–everyone talks about low costs. I mean, how expensive is it when you don't truly understand what you own and suffer permanent capital loss? It's like when commissions dropped under $10 per trade; it was like giving the dynamite away for free. Time and time again people mistake speculation with investing and don't have a clue how disruptive permanent loss is to the power of compounding. In this environment, at least if you're in the developed countries, you need to look at the forces of deleveraging. Our debt levels are higher today than they were in 2008 or 2007, so one could argue that the much needed deleveraging has been masked by the repression of interest rates by the Fed. That is why we gravitate toward businesses committed to delivering quality low ticket necessities, especially in areas of the world undergoing rapid urbanization.

In the environment you're talking about, what kind of company will do well?

We just look globally and we ask, "Where are there fundamentals that are not dependent on the government?" In other words, we like free markets. So we look real wide and then we say, okay, Indonesia has exciting fundamentals, right? We just look at where are people working hard. Where they are saving their money. Where are they aspiring? The other thing is that you're looking at the most rapid globalization in the history of man in China and Asia. So what happens when you urbanize, you have to feed those people, or they will riot. To do that you need scale. Currently the demand for necessities like personal care and food is growing 2 to 3 times faster than the economy. There are 1.8 billion in the global middle class which is growing by 150 million people annually. . . We may add a billion people over 15 to 18 years. Those people are moving up in the basic necessities starting with protein in the diet. The number one concern in China is food safety. What we are looking for are businesses that have a culture to put out high quality products and service and are concerned with maintaining the trust of their customers. We want to buy those businesses when the mood is dour and we have a compelling price point that allows for the double to triple play return over 5 years.

When we look at the company, we should look at the fundamentals, not just the P/E of course, the balance sheet. What else should we look for? Assets, margins?

You're looking at the accounting and the integrity of the accounting first. Can you trust the accounting? You want consistent and growing cash flows that can provide for growing dividend streams. As a business analyst you want to look at the entire capital structure of the company and value the stock as a credit analyst, and the debt from an equity standpoint. What's the integrity of the balance sheet? What's the attitude towards leverage? The banking industry in 2007 was paying above-average dividends but they were disguising extreme borrowing to pay those dividends. .By constantly studying both the debt and equity of our companies we were able to take advantage of the tremendous bargains in the 2009 corporate bond collapse. You're looking at the fundamental direction of the balance sheet, too. There are a lot of businesses that we just won't buy because of the lack of predictability. We'll buy the debt instead of the stock. Does the management want to put out the best possible product? Do they love the business? Do they overpay and over borrow for acquisitions? Do they price their stock buybacks or overpay, destroying value? So few CEOs buy based on price--usually animal spirits are the overwhelming factor. . Often we'll own a small position in a company for five years before we buy it in a material way. . In our fund we have a lot of trackers. Then over time you kind of get comfortable, but like I said there's no shortcuts, and there's no one metric. A lot of people will screen based on P/E ratio, but you have to know the business. There are too many outside influences in a competitive global economy. Just look at technology, look at what's happened to industry leaders Hewlett Packard, Nokia and Dell. Look at all the bookstores and newspapers—in a knowledge driven economy! So it all comes down to being a voracious reader daily on trends as well. But it does start with the integrity of the accounting that goes to the balance sheet, because without a strong balance sheet it is difficult to endure.

Sometimes I've heard people say to avoid news, but when you listen to or read the news every day, read what's in the media every day, will you be influenced by the media?

What we're trying to find every day is who is fundamentally at the top of their game, who is executing, who's really good? And then when those get hit on the news, there's a temporary problem or something, we'll be there ready. The true long-term investor is very price-oriented. Great investors are rational and become active in panics. Carlos Slim was a major investor in 1982 when Mexico defaulted. Recently, he announced that it is time to shop in Europe. So crisis is opportunity. We like it when there's recurring horrible news surrounding a quality business franchise, something that is priced for an extremely bad outcome. You contrast that with the extremely popular high expectation stock, the stock everybody loves, like Cisco (CSCO) in 1999. The story is great, the price earnings ratio high, the expectations are high, and then they miss and it torpedoes your whole portfolio. So we like the horrible -to-bad trade. The price reflects a horrible outcome but things turn out bad and you do well with much less risk. During the uncertainty surrounding the growth of government in healthcare, we were able to invest in WellPoint (WLP) which was sporting a 20% free cash flow yield. Stocks need to be purchased when their prices are low so recessions and depressions are an exciting time for the patient long term investor. Since 1947 the U.S. has been in recessions less than 5% of the time.

That's actually very interesting. This is what Don Yacktman said, too, in our conversation on Monday. He was basically saying to buy good companies when bad news hits, which is similar to what you are saying. I also found that you own lots of companies that he owns too, like Philip Morris, Pepsi, Microsoft, Walmart – is that just a coincidence, or because you have a similar philosophy, or you get ideas from each other?

Don is one of the greatest investors on the planet. I would trust him with all of my family's money. However, I learned back in the 1980s, you have to do your own homework and see it with your own eyes. You need to build your own database with what you are comfortable. Then in market declines you have the conviction to buy in the face of seemingly insurmountable problems. Rarely do I get ideas by talking to other investors, mostly through analyzing individual businesses one by one. You need to extract the facts yourself.

Do you talk to management when you do your research?

I do attend conferences where I meet and listen to management. We've had management meetings over the years, but now it's less and less because what I've found is that a lot of the CEOs are great salespeople and can be extremely charismatic. This was the case with many of the large banks. Talk can be cheap. I think it is important to do all the work to grasp the operating reality of the business and then meet management. Start with the numbers, the balance sheet and the fundamentals. John D. Rockefeller preached the power of managing off the ledger, which removes the emotion and helps to maintain rationality. . . . I should say some of our great investments have been uncovered at conferences late on Friday afternoons when most analysts have cleared out. We bought Express Scripts years ago after attending a 4 o'clock Friday presentation. The stock was trading nine times earnings while enjoying a 15% growth rate--- less than $4 on today's price. It pays to work hard to focus on the "knowable" factors that can make a business successful.

How about value traps? We talked about value traps lately, where people are thinking companies like RIMM, HPQ, DELL, might be value traps. What kind of companies are value traps in your opinion?

Being a dedicated researcher and a student of history helps in avoiding value traps. You need to look at a business in its entirety. You need to assess the forces of supply and demand, the technology, the heart and diligence of management. Why is it down? Is it a fixable, temporary problem? Changes in technology like the digital trend, has been responsible for numerous value traps. Often, post-bubble bottom fishing can lead to value traps as years of demand have been robbed by extremely accommodative monetary conditions. Often after a bubble burst, the companies tend to bounce along the bottom for extended periods. Generally over time if you go back in history, few technology stocks have endured. Tech is fabulous for the consumer. Years ago we invested in Nokia (NOK) when it was more of an old line industrial company. Our adjusted basis was about $2. Then it went to $50, and we sold half of it at $50. Then it dropped to $40, and we sold half of the remaining half. Subsequently we sold most of it down around $30, and now it's all the way back under $2. And this was an industry leader in phones! You look at Samsung and Apple and the competition, the potential supply from other carriers. We want a fixable problem with an enduring business. Another good example of post bubble bargain hunting took place for me back in 1985. After the oil boom bust, we bought the industry leading drilling company Schlumberger (SLB) when it dropped from $90 to $32. I thought we nailed it right at the bottom, and we did. However, in the next five years it only appreciated $32 to $39. The boom and high prices of oil in the 1970s attracted so much capacity, together with the advances in drilling technology, that the hangover lasted for a much longer period than we'd envisioned. Today, I prefer companies that will benefit from the lower inputs that can result after a bust.

The tail lasts very long in your opinion, right? The boom bust, then the tail, lasts extremely long.

Yes. Just look at Japan and the result of government intervention. Since 1999 in the U.S. we've had incredibly accommodative monetary policy leading to a number of investment bubbles. The heavy intervention by the Fed prolongs the purging process. It takes much longer for the supply and demand to correct.

Yes, I think I agree with you. So that's why you own companies like Philip Morris, Pepsi, Microsoft, Walmart. What do you like most about Philip Morris (PM)?

I like products that people buy frequently that are lower ticket, especially in tough economic times. The global population recently surpassed 7 billion. Most people just want to get through their day with a little pleasure. They want a cup of coffee, a bite of chocolate, a cigarette, a beer, a Coke, whatever, a little boost to get them through. So we like the fact that people are going to buy that product every day, by their choice. They aren't forced to buy it. The government is not forcing them to buy it. It's not like a windmill or solar installation that requires a government subsidy to survive. I want a product people buy because they aspire to a higher standard of living. Recently throughout Asia and China, there is a movement away from the cheap knockoffs and a push for higher quality, especially with regard to food. They want the real thing. People want to buy quality Western brands. The disclosure provided by the internet is driving envy. People want to live better. I look at what people are using by their choice, what they like to do every day, and that source of demand. We have $400 billion a year in housing subsidies. How do you figure out the real supply demand there? Russians are going crazy over Doritos because they love the taste.

So something that a consumer consumes directly, like Pepsi (PEP) also?

Yes. If you look at the demographics related to food in Asia – the rapid urbanization – the thing is you need scale to hit that market. You can't do it as a small company. And much of Pepsi is in snack foods. That again is the lower-ticket. As far as the execution in Asia, the Frito Lay part is kind of what we were buying. The best operating soft drink company we own is Dr. Pepper (DPS). It's really been doing the best operationally. Pepsi is active in addressing the wellness trend. It's more that they are working to make better quality products, but they also have the scale to approach the urbanization. If the food dynamics are growing 2 to 3 times faster than the economy, who's going to do it? It's going to be like a Tesco, and a Pepsi and a Wal-Mart. You've got to have the scale. That's why we like Tesco, too.

I see. That makes sense. I noticed that you have Apollo Group (APOL), this online education company. There are lots of troubles these days with for-profit education companies. What is your opinion there? Why do you still own this company?

We've been in and out of Apollo for the last 10 years. For-profit education is now restructuring to adjust to more stringent regulations and tighter lending standards. Like housing, easy money infiltrated educational lending and now companies are adjusting to a tougher, slower growth environment. With over 300,000 students, Apollo is an industry leader and should survive the shakeout. Competitively, they have a very strong balance sheet, high returns on assets, and a tremendous free cash flow. There is a strong need in the marketplace for schools to better adapt the students to a constantly evolving workplace. Manpower projects an acute shortage in skilled labor over the next twenty years in the U.S. Apollo and other for-profit colleges have the financial flexibility to adapt to these challenges and I believe can still thrive in the long term. Our investors have benefited by investing in businesses under regulatory assault which can lead to compelling bargains.

Can you tell us about your high school background and how important an education has been for you and what advice would you give someone thinking about starting a fund, and are there any pitfalls that you ran into that you would encourage them to watch out for?

In high school I was very involved in competitive sports. I was an all-conference quarterback, captain of the basketball team, and scholar athlete representative from our school. I actually was offered a football scholarship to the Air Force Academy. The great value in athletics is learning to love competition, meritocracy and the importance of preparation—great training for survival in global free markets. When it was time for college I asked Mr. Pamplin for his advice and he was very convicted---take accounting at a public school. Because accounting is the language of business, and even though he was a heavy contributor to many top ranked private schools, he just said if you want to be a great investor you have to know the language of business.

Were there any pitfalls that you encountered?

We started the Auxier Focus Fund in 1999 at the height of the internet frenzy. Not the greatest time for value investors. We didn't really have any pitfalls with regard to the Fund because it was such a passion and so much fun. I sunk a large percentage of my net worth and 100% of my retirement into the Fund and have purchased the Fund virtually every month since inception. I wanted to display my diligence at the craft of investing. The problem today with starting a new fund is the supply/demand imbalance. There are too many funds on the market. It is crowded. The cost of regulation is higher; together with the plethora of choices, you'd better have an enormous commitment to research excellence and be committed to the very long term.

Jeff Auxier GuruFocus Interview: Part 2

Sep 20, 2012 by Holly **LaFon**

GuruFocus: You're buying a lot of global brands, and they all had in common emerging market growth, like Proctor and Gamble (PG), Pepsi (PEP), Philip Morris (PM), Johnson and Johnson (JNJ). Is that was a conscious investment theme or is that a coincidence?

Jeff Auxier: Some of the best fundamentals surround the roughly 150 million new entrants that are annually entering the global emerging middle class, which now numbers approximately 1.8 billion. This segment spends between $10-$15 trillion a year. The internet is fueling envy and a new group of consumers seeking truth and trusted brands. Ironically, despite the current global protests against America, there is a powerful desire for quality Western brands. The U.S., France and Norway are the most food-secure countries in the world today. U.S. farmers feed 20% of the world's population on just 10% of the world's land. As incomes rise, so does the demand for a better diet and healthcare. Many of the U.S. multinationals enjoy a reputation for quality and have the scale in distribution to meet this growing demand. Poor execution on the part of JNJ and P&G this past year provided attractive entry price points for both stocks. Each company owns a plethora of leading brands that if spun off could provide tremendous returns for shareholders. Over 80% of acquisitions destroy shareholder value; spinoffs have had a much better record of outperforming the averages within 24 months. While Greece and Europe dominate with negative headlines, countries like Indonesia, Malaysia and the Philippines offer exciting underlying trends.

And about Pepsi, he says that it's been out of favor during the tech years but a lot of defensive names are all the rage, and is your portfolio tilted towards consumer defensive names because of your macroeconomic view, and it seems a more contrarian approach would be a more bullish approach on cyclicals like ArcelorMittal (MT) or Fiat (FIA).

We like products that are purchased because of free will, not a government stimulus program. You have to look at the big picture and the individual businesses. We try to be very disciplined with the price we pay but also about the quality of the business. Once you accumulate debt, historically it is difficult to reduce through austerity. If austerity is too harsh, people riot. It takes time. So we're in a multiyear deleveraging period, and when economies are deleveraging, low-ticket necessity items tend to have a better risk/reward. China's fixed investment levels were unprecedented this past decade. The hangover from their massive stimulus is very difficult to analyze. When the government is a big part of creating the demand for your product, like steel, it can be hard to quantify. We need much greater predictability.

Okay. And thinking about Proctor and Gamble, what are your thoughts on its moat in terms of some of those increasing commodity-like industries such as soap, cough syrup, etc., that are subject to private-label competition?

Companies need to constantly innovate to provide better value for their customers. They need to communicate the value. Globally, consumers have been willing to pay up for healthier products that will benefit them longer term. There is a tremendous opportunity for businesses that are on a virtuous cycle working to provide better value for their customers all the time. Unilever has done a good job staying close to their customers and has outperformed P&G, in my opinion, in many foreign markets. P&G is not executing up to its full potential. They may need to reenergize brands through spinoffs. Apple (AAPL) exemplifies the positive result of a tenacious drive to provide a superior product for the customer.

How would that same question apply to some of your other holdings, like Johnson and Johnson, or Molson Coors Brewing, or maybe Philip Morris?

Philip Morris has operationally done an excellent job since the split from Altria (MO). Johnson and Johnson suffers from a lack of quality control in many of their products. These are fixable, and again the tremendous lineup of leading brands offers investors good potential with spinoffs.

The other one was Molson Coors Brewing (TAP).

Oh yeah, again, they're really cheap. They're the oldest brewer in North America, and the stock is running about 10-11 times earnings with a very strong balance sheet. If you look at what Heineken is bidding for Asia Pacific Breweries (15-17 times cash flow), Molson looks like a bargain. The company has been innovative in coming out with new products, especially in the craft beer area. Their customer base is mostly unemployed, so that's kind of the problem. But usually if we can buy a beverage company at 10x earnings, we're pretty patient. Historically it's been a pretty good entry point.

Okay. Is that why you would invest in American brands over European brands or other brands in China or Brazil?

We just want a quality brand and honest, diligent management where we can find it. The problem with many foreign businesses is the integrity of the accounting. We like Western accounting better. So we would much prefer a company that makes a quality product with conservative accounting. The added transparency on the Internet benefits the good operators as the news of poor quality and dishonest behavior travels fast. We want businesses to focus their energy on a superior product or service, not financial engineering.

Okay. Great. Did you and Charlie talk about the euro zone? Where do you see that situation going and do you think any of the countries will default?

Well, Greece has been in default over 50 percent of the time since the early 1800s. It is built into their DNA. They never had the finances to join the euro zone in the first place. Spain's recession has been more of a traditional downturn driven by the excesses of real estate development. The inflexible labor markets throughout Europe add to the challenges. The perception of a "safe government" is quite the oxymoron. According to Reinhart and Rogoff, if you look back eight centuries, only six countries have paid their bills. Only six in eight centuries. Throughout history where there is an excessive accumulation of debt, restructuring follows. This leads to bargains opportunities. Recently Carlos Slim announced that Europe is now a good buy. Remember, he was extremely active in buying businesses in 1982 after Mexico defaulted on their debt. J. Paul Getty started buying oil stocks under book value after 1930 during the Great Depression. Historically, the great investors come alive in panics, recessions and depressions because of low prices--that's when you really want to work overtime as an investor. Attractive prices should dictate higher activity.

Charlie: Yes, I have a question. Do you think the opportunity is more in stocks or in debt, or both? If you look at Spain, the biggest companies in Spain, one is a bank, Bank Santander (STD). The other is Telefonica (TEF), a phone company. What other opportunities do you see there?

I think there are huge opportunities with Telefonica. They have solid assets that can be monetized. They recently cut the dividend, so we actually have been buyers of both the debt and stock. We like the Spanish-based companies that are globally exposed--and Telefonica's less than one-third in Spain, they're in Germany, they've got assets all over Europe, and then also in Latin America. So, on a price basis, since they have cut the dividend, the debt is interesting. They have a number of companies that they can take public where they can reduce the debt.

What do you think about the U.S. housing market? Where do you think it will go?

The problem I have with housing is the artificial repression of our interest rates. The Federal Reserve has removed the free market pricing mechanism. It is masking the needed fiscal reform. The U.S. provides $400 billion a year in housing subsidies. There is no stigma in strategically defaulting. With easy money people are gaming the system. What would happen if you brought the free market back to the bond market? According to Jim Grant, the Greek long bond yielded only 20 basis points over the German long bond back in 2005. Look what happened to those interest rates in Greece. Look at California, the world's seventh largest economy, and they have just approved a massive $100 billion bullet train. The history of railroad defaults in the 1800s is not encouraging. Too big to fail? What if California or Illinois needed to be bailed out? What happens to housing values if the market were to price the risk? Government intervention in Japan led to a housing market that has been in a downward spiral for 17 years. It is very difficult to get a true read on the supply and demand for the U.S. housing market today.

Okay. Makes sense. Are you optimistic about natural gas? How are you investing in it, and what is your outlook on fossil fuels versus alternative fuels?

Human ingenuity and the tremendous advances in technology contribute to the speculative nature of undifferentiated commodities. Through fracking and horizontal drilling we have glutted the market with natural gas. We have the technology to just totally meet all of our energy needs, it's pretty exciting, and it's really politics that is standing in the way. Natural gas at these prices is maybe equivalent to $20 oil, so that's really already leading to a huge competitive manufacturing advantage. Now companies are looking to shorten their supply chains. In China, natural gas is maybe anywhere from 6 to10 times more expensive, same with Europe. Instead of buying direct producers, we would rather buy the beneficiaries of lower inputs. We like companies that benefit from lower technology costs, and we like companies that benefit from lower energy inputs. The technology exists for much lower oil prices as well. The branded packaged goods companies should benefit from those lower inputs. But to play it directly is really tough. I remember back in the early 1980s witnessing the boom-bust cycle with the stock of Texas Oil and Gas. In the late 1970s it was a top performing natural gas producer, and then once that boom busted, it was flat for years. Commodities are tough. We are coming off a China-driven 115-month commodity boom that exceeded the tech boom and the housing boom in duration. Once the public is sold on the trend it can become treacherous. Lending standards tend to get sloppy. Wall Street kind of went crazy with the financing of Chesapeake. It was similar to Enron, where the off-balance sheet funding seemed like it would never fall out of favor. If we were to invest in the sector it would be with a company like Apache.

Why do you like it?

They're just really sensible about how they acquire reserves, sport a strong balance sheet and sell at a steep discount to reserves.

Alright. I think you touched on this with Charlie a lot, about your mentors? And so do you have anything to add? Were there any moments in your investing that changed your views, or were eye opening, throughout your career. Might have changed your path a little bit, or someone you met that changed your thoughts about things?

In business, primarily Robert Pamplin. The call in 1982 to Warren Buffett was critical in establishing the framework to endure longer term. The best thing I did was to energetically focus on that price-value-margin of safety approach. An example of how valuable the lessons proved: I had a client in 1985 who entrusted me with $1 million and we just sat down and we went through all the Berkshire Hathaway (BRK.A)(BRK.B) annual reports and started attending the Berkshire meetings. That $1 million compounded to $6 million by 1992. Achieving those results while employing a systemic, low risk approach hooked me for life.

Yes. Just some comments here. You were really lucky to get Warren Buffett to answer your call in 1982. These days if you call him maybe even his secretary is too busy to answer your phone.

He has contributed so much for so many with his education on the proper way to invest. Like what Gurufocus is doing today. Capital allocation is critically important in a free market system and if it's done poorly, the consequences can be devastating to people's lives. Gurufocus provides a very valuable educational service—one of the best I have seen. It still comes down to the daily voracious researching. You can have a strong track record, but if you're not committed daily to a rigorous fact finding effort it is difficult to protect against permanent capital loss. Gurufocus provides the sound fundamental approach needed to endure the most difficult market conditions.

Thank you very much.

Phenomenal, what you guys do.

I have a last question. You live on a farm right?

Right, yeah.

Does that give you an advantage in investing?

I think it does. We actually have a producing farm with cattle, timber and hazelnuts. We export to China We see supply and demand at a very base level. Supply and demand to me is critical in investing. Humility is a big component as there are no shortcuts in farming. The work has to get done every day. You need to get a high quality product to the market. It is not easy. For kids it's a great training ground. Farming combines biology, chemistry, mechanics, engineering, mathematics. I purchased the farm in the late 1980s and in hindsight it was one of the best moves of my life. Investing and farming are similar--you're planting and compounding. A true investor tends to plant in the "hopelessly out of favor" and then harvests during "emotionally euphoric." Like farming, the investor needs persistence and dedication to stick to a disciplined research regimen. An effective risk manager combines humility, persistent fact-finding and cumulative knowledge together with the proper temperament. Mr. Buffett's advice about living far from Wall Street was so valuable--I took it to heart. John Templeton is another example of an outstanding investor who did much better after moving to the Bahamas from New York. Better to do your own thinking far from the emotions and swirling rumor mills.

Thank you very much. It was a great pleasure to talk to you.

Thank you, any time. You have a great site.